Overview of the Banking Industry in Kenya

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Introduction

The Kenyan banking industry has experienced considerable growth in the past few years. The banking sector was robust and stable and registered enhanced performance in 2013 as demonstrated by a growth of 15.9 per cent in the total net assets of the banking industry and an increase in Customer deposits of 13.5 per cent in that year.\(^1\) In addition, there has been an expansion of banks across Kenya, through the establishment of branches and other places of business, an increase in the availability of mobile financial services and greater usage of the agency banking model to allow commercial banks to engage third parties to offer specified banking services on their behalf.

As at 31 December 2013, the Kenyan banking sector comprised 44 banking institutions, seven (7) representative offices of foreign banks and several financial institutions, including building societies and mortgage finance companies. The banking industry is dominated by five major banks: Kenya Commercial Bank Limited, Equity Bank Limited, Co-operative Bank Limited, Standard Chartered Bank Kenya Limited and Barclays Bank of Kenya Limited.

It should be noted that the majority of Kenyans engage in “mobile banking” through use of mobile payment systems operated by mobile communication companies such as M-Pesa by Safaricom. M-Shwari, an innovative mobile platform for Safaricom’s M-Pesa customers, enables individuals to access banking services from their phone. Subscribers can deposit and borrow

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money, as well as earn interest on money deposited, using their mobile phones.

This article discusses the key regulations and regulatory authorities, and the licensing process relevant to setting up a commercial bank in Kenya.

1. Key regulations in the banking industry

1.1 Regulatory framework

The primary legislative sources of regulation in the banking industry are as follows:

- Banking Act (August 2014) (the “Banking Act”)
- Microfinance Act (2006)
- National Payment System Act (2011)
- Kenya Deposit Insurance Act (2012)

The main regulations and guidance in the banking industry are as follows:

- Guideline on Non-Operating Holding Companies (2013)
- Guideline on Incidental Business Activities (2013)
- Prudential Guidelines (2013) (the “Prudential Guidelines”)
- Banking (Credit Reference Bureau) Regulations (2013)

1.2 Regulatory authorities

The Central Bank of Kenya (the “CBK”) has overall regulatory authority over the banking industry in Kenya. In the past few years, the CBK’s supervisory role has been strengthened by numerous revisions to the Banking Act, the Central Bank of Kenya Act and the Prudential Guidelines. For instance, more
legal powers have been given to the CBK by broadening the responsibilities and coverage of institutions by the Banking Act.\(^2\)

If the CBK has reason to believe that the business of a regulated institution is being conducted in a manner that is contrary to the provisions of the Banking Act, or in a manner which is not in the best interests of its depositors or members of the public, then it may give advice or make recommendations to the institution.

The CBK may also issue directions and implement measures to improve the management or business methods of the institution, or appoint a person to advise and assist the institution. The CBK has the power to appoint a manager if (1) an institution, for example, fails to meet any of its financial obligations, (2) a petition is filed for the winding-up of the institution, (3) the CBK becomes aware of any fact which warrants the exercise of its power, or (4) the institution is significantly undercapitalised. A manager so appointed has the power, inter alia, to assume management control of the institution to the exclusion of its board of directors, and declare moratorium on payments by the institution to its depositors and creditors.

### 1.3 Licensing

Pursuant to the Banking Act, any person who undertakes “banking business”, “financial business” or the business of a “mortgage finance company” shall obtain prior license from the CBK. When the CBK reviews an application for a licence, it must consider the financial condition and history of the institution, the professional and moral suitability of the persons proposed to manage or control the institution, and the extent to which the public interest will be served by granting the licence.\(^3\)

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\(^3\) Article 4 of Kenya Banking Act.
The CBK has the right, when granting a licence, to impose such conditions as it considers necessary, and may from time to time add, vary or substitute such conditions as it deems appropriate. The primary distinction between “banking business” and “financial business” is that a bank engaging in “banking business” has the right to accept and employ money on current account, and to accept cheques.

The CBK may also authorise a bank or financial institution incorporated outside Kenya to set up a representative office in Kenya if it does not want to undertake normal banking business. As at 31 December 2013, around seven (7) foreign banks had set up representative offices under such authorisation.

2. Process for setting up a commercial bank in Kenya

The followings are the key steps to be followed when applying for a licence to set up a commercial bank, non-bank financial institution or mortgage finance company⁴ in Kenya:

(1) Contact the CBK for a preliminary meeting to discuss the licensing requirements and related issues;

(2) Seek the CBK’s approval for the use of the word “bank” or “finance” in the proposed name;

(3) Once the CBK has approved the name, apply to the Registrar of Companies to incorporate the proposed bank, mortgage finance company or non-bank financial institution as a limited liability company;

(4) Upon incorporation of the limited liability company, apply to the CBK for a banking, mortgage finance company or non-bank financial institution licence;

At this stage you should contact the Bank Supervision Department of the CBK or download and complete the following application forms which can be accessed from the CBK’s website, www.centralbank.go.ke:

i) “Application form for a License to Conduct the Business of an Institution” (Form CBK IF 1-1);

ii) “Fit and Proper” forms for proposed directors and Chief Executive Officer (Form CBK IF 1-2); and

iii) “Fit and Proper” forms for all significant shareholders (Form CBK IF 1-3);

(5) The duly completed application form (Form CBK IF 1-1) should be submitted together with the supporting documentation set out below:

i) Certified copy of the certificate of incorporation of the proposed institution;

ii) Certified copy of the Memorandum and Articles of Association of the proposed institution;

iii) Certified copy of the Memorandum and Articles of Association of any corporate body that proposes to have a significant shareholding in the institution;

iv) Certified copy of the latest audited financial statements for each of the three years immediately preceding the date of the application if the applicant has been operating in any sector under any name and laws or in cases where any of the shareholders is a corporate body; and

v) Where the proposed significant shareholders are natural persons, certified personal statements of affairs for the past three years should be submitted;

(6) All applications should be submitted together with a non-refundable application fee, paid by banker’s cheque in favour of the CBK or such other
method of payment as the CBK may prescribe, as specified under the Fourth Schedule to the Banking Act (the Banking (Fees) Regulations). The application fee is currently KSh 5,000;

(7) In case of an institution incorporated outside Kenya, in addition to notarized copies of the documents specified in (6) above, the following should also be submitted:

i) A notarized copy of the signed minutes of the board of the institution, or other primary oversight body, passing the resolution to establish a branch or subsidiary in Kenya;

ii) An undertaking by the board or other oversight body to maintain the required minimum assigned capital in the proposed branch or subsidiary in Kenya, as per the Banking Act, and that such capital shall be in Kenyan shillings;

iii) The name and contact details of the designated person(s) from the head office authorised to liaise with the CBK on behalf of the institution in relation to the application;

iv) A letter of no objection from the home supervisory authority recommending that permission be granted for the applicant to establish a branch or subsidiary in Kenya (The letter should be forwarded directly to the Director, Bank Supervision Department, Central Bank of Kenya, P.O. Box 60000-00200, Nairobi.);

v) It shall be noted that the home country supervisor will exchange supervisory information with the CBK;

vi) Confirmation from the home country supervisor that the promoters of the foreign incorporated bank do not operate a shell bank; and

vii) Where necessary, confirmation from the home supervisor that the supervisor conducts consolidated supervision;
(8) Sworn declarations should be signed by every officer as specified in the application forms;

(9) A feasibility study should be carried out into the operations and development of the intended business over a minimum period of three years from the date of the application, including:

   i) A comprehensive diagrammatic representation of the group structure, if the applicant is part of a group of companies (either as a parent, associate, subsidiary or joint venture), indicating details of all respective individual and institutional shareholdings within the group as well as the ultimate beneficial shareholders.

   ii) The proposed organisational structure of the proposed institution, showing:

       • Proposed Board of Directors;

       • Proposed CEO, Executive Directors and Senior Officers; and

       • Proposed functional divisions;

   iii) An up-to-date and detailed curriculum vitae for each significant beneficial shareholder (i.e. each shareholder controlling, directly or indirectly, more than five (5) per cent of the proposed institution’s issued equity), each director and any senior officer who will take part in policy making, as well as certified copies of supporting documentation including (where applicable):

       • Academic and professional certificates;

       • Contact details (postal and e-mail addresses, and phone contacts) of at least three (3) independent referees, one of whom should be a previous employer or business associate;

       • Valid Personal Identification Number (PIN) and tax compliance certificate issued by the relevant tax authority in Kenya;
• The latest credit report from a licensed credit reference bureau;

• Certified statement of personal financial affairs; and

• Two (2) recent passport-size photographs;

iv) A schedule of all preliminary expenses including organisation costs, share-selling and brokerage costs and commission payments;

v) Projections of financial statements for the first three years of operation;

vi) An interest rate sensitivity analysis of the projections submitted or other similar analysis of the extent to which the projections will change if interest rates vary;

The assumptions underlying the projections and the sensitivity analysis should be stated.

vii) The proposed operational arrangements of the applicant, showing details of the proposed functional divisions and units, the functions that will be delivered in-house and those that will be outsourced;

The rationale for outsourcing and the risk-mitigation measures in place should also be provided.

viii) Any statistics and other data that has been collected in respect of the applicant’s intended service area, including the population of the area, schemes of agriculture, businesses, industrial development and existing banking facilities;

(10) Sources and evidence of availability of capital, including details of the sources of capital contributed by all proposed significant individual and institutional shareholders (i.e. those controlling, directly or indirectly, more than five (5) per cent of the applicant’s proposed issued equity) and evidence demonstrating the applicant’s capacity to meet the minimum
capital requirements of the proposed institution as stipulated in the Banking Act;

Evidence to be submitted may include certified copies of bank statements, Fixed Deposit Receipts (FDRs) or Government Securities. Currently a minimum capital of KSh 1 billion is required to start a bank or a mortgage finance company.

(11) Every proposed individual and institutional shareholder should submit, as part of the sworn declaration in the “Fit and Proper” form (CBK IF 1-3), a statement to the effect that the proposed capital does not constitute the proceeds of crime or illicit activities;

(12) Upon meeting all the requirements, the CBK will grant the applicant approval in principle to conduct the business of a bank, mortgage finance company or non-bank financial institution, as the case may be;

(13) With this approval, the applicant may proceed with obtaining premises, Information Technology Systems, putting in place other necessary operating facilities and recruiting staff for the institution;

(14) Once the applicant’s premises and systems are in place, the applicant should invite the CBK to conduct an inspection of the premises;

(15) If the inspection is satisfactory, prior to issuing the license, the applicant is required to pay the prescribed annual license fee as specified under the Fourth Schedule of the Banking Act; and

The prescribed annual license fee is payable in full for the year during which the license is issued, and shall not be prorated for periods of less than 12 months.

(16) Once the requisite license fee has been paid, the CBK will place a notice in the Kenya Gazette to formally announce establishment of the institution.